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C O N F I D E N T I A L SECTION 01 OF 03 CARACAS 000038

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ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD
NSC FOR DTOMLINSON

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TAGS: [EPET](#) [ENRG](#) [EINV](#) [ECON](#) [VE](#)
SUBJECT: CNPC'S VENEZUELAN WOES

REF: 2006 CARACAS 02881

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

11. (C) SUMMARY: CNPC executives stated Sinovensa, the joint venture between PDVSA and CNPC that produces Orimulsion, no longer produces the product on orders of the Ministry of Energy and Petroleum (MEP). CNPC views the situation as an expropriation and has reserved its rights to arbitration. The executives also expressed frustration over the migration of their operating service agreement field to a PDVSA controlled joint venture and concerns over the personal security of their employees. END SUMMARY

ORIMULSION

12. (C) Econ Counselor and Petroleum Attache (Petatt) met with CNPC President and Sinovensa General Manager Qingping Li (strictly protect) and CNPC Vice President Jinling Zhang (strictly protect) on January 5 to discuss the current operating environment in Venezuela. Zhang confirmed that Sinovensa stopped production of Orimulsion on December 31 on orders of the MEP. PDVSA has stated publicly that Sinovensa will be restructured into a joint venture and that its output of extra heavy crude will be mixed with lighter crudes for marketing purposes.

13. (SBU) Orimulsion is an emulsion composed of 70 percent bitumen and 30 percent water that is used as a power station fuel or in the heavy industry sector. PDVSA, via its Bitor affiliate, signed an agreement with CNPC in 2001 creating a joint venture, Sinovensa, for the purpose of producing Orimulsion. Under the agreement, Sinovensa constructed an Orimulsion facility with a annual capacity of 7.25 million metric tons as well as shipping facilities. According to

PDVSA's website, the production facility required an initial investment of 360 million USD. The facility received its bitumen from an 11 square kilometer field in the Faja region that produces roughly 90,000 barrels of bitumen daily.

THEY ARE CRAZY

14. (C) Zhang stated CNPC is treating the MEP order as an expropriation and expects to receive fair compensation for its investment. Zhang stated the MEP originally advised CNPC of its decision to halt production by December 31, 2006 via letter on September 25. Based on Zhang's comments, CNPC apparently thought that it could negotiate with the MEP but the MEP quickly disabused it of the notion. CNPC decided not to fight the decision but has reserved its rights to international arbitration. It appears that CNPC is currently negotiating with MEP on the issue of compensation. Zhang complained that she deals with Orimulsion issues on a daily basis.

15. (C) When asked about the Orimulsion supply contracts, Zhang mentioned that a power plant in China had been modified to use Orimulsion. In addition, she stated companies in Italy and Canada had Orimulsion supply contracts. Zhang added there were rumors the Canadians intended to sue over the suspension of Orimulsion deliveries. She was not sure what the Italians planned to do. (NOTE: According to the PDVSA website, the Fiume Santo power plant in Sardinia was modified to take Orimulsion. The plant is owned by Endesa Italia and supplies Sardinia with 60 percent of its electricity. PDVSA estimated in 2003 that the plant would

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utilize a million tons of Orimulsion per year. We were unable to find any information on the use of Orimulsion in Canada. END NOTE)

16. (C) Zhang stated several times CNPC does not understand the rationale behind the MEP's decision. It is easy to understand why CNPC is bewildered. The September 25 letter terminating the production of Orimulsion came on the heels of President Chavez's August 2006 visit to China as well as a September visit by high level PDVSA officials. Both Chavez and the PDVSA officials signed a number of energy MOUs during their visits. Chavez has also repeatedly and publicly stated that he views the Sino-Venezuelan energy relationship to be of the utmost importance.

17. (C) On October 18, President Chavez publicly inaugurated the first of 18 test wells that PDVSA and CNPC will use to certify the reserves in the Junin 4 block of the Faja. During the ceremony, Chavez was quoted as stating Venezuela is committed to raising its oil shipments to China to 300,000 barrels per day in 2007 and 500,000 in 2008. Surprisingly, Zhang was not upbeat about the Faja project. She stated that China and Venezuela signed an MOU for the creation of a joint venture to develop a block in the Faja. However, the BRV then stated that no company would be guaranteed a block in the Faja and that blocks would be assigned via bidding. Zhang stated that it did not make any sense to sign the MOU for the joint venture if it is not guaranteed a block. She complained the BRV did not appear to have any plan for the development of the Faja but just made things up as it went along. A clearly exasperated Zhang summed things up by mumbling "They are crazy."

ADDITIONAL CONCERNS

18. (C) Li, who arrived in Venezuela three months ago, appeared to be fixated on security issues throughout the meeting. He told Econ Counselor that CNPC employees had repeatedly been the victims of street crime and kidnappings and was clearly concerned about his Chinese employees' safety. At one point, he noted that while the heat and

grinding poverty were drawbacks to working in Sudan, the level of criminality was less than in Venezuela. He frequently brought the conversation back to security issues and was extremely interested in the Post's perceptions of the security situation as well as U.S. companies' views. As in previous meeting with CNPC executives (Reftel), Li also complained about Venezuelan labor regulations and the work ethic of Venezuelan laborers. When asked about the migration of CNPC's operating service agreement field to a joint venture, Zhang stated nothing had changed since our last meeting (Reftel).

COMMENT

19. (C) Although it is easy to understand why the CNPC executives are frustrated and bewildered by the MEP and PDVSA, CNPC's woes merely confirm three clear trends. First, despite Bolivarian rhetoric to the contrary, companies that are viewed as "teacher's pets" due to their home country's "special" relationship with Venezuela have not received any special treatment. All of the companies have been treated the same when it comes to tax disputes and issues arising out of the migration of the operating service agreements and strategic associations to PDVSA controlled joint ventures. Despite Chavez's frequent public exclamations on the

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importance of the Sino-Venezuelan relationship, at the end of the day, CNPC was treated just as poorly as one of the international oil companies from the United States.

110. (C) Second, the Orimulsion saga offers strong evidence that MEP Vice Minister Bernard Mommer is still the driving force behind Venezuelan hydrocarbon policy. Mommer has been obsessed with Orimulsion for years. Mommer believes that Venezuela should focus on value added products with higher profit margins. He told Zhiang that he "lost his job" in the old PDVSA due to his opposition to Orimulsion. (Note: Mommer was Senior Advisor for Strategic Planning Co-Coordination at PDVSA from 1991 to 1995. End Note) We view the termination of the Orimulsion program after CNPC had invested significant sums of money in it as clear evidence of Mommer's continuing dominance of hydrocarbon policymaking.

111. (C) Finally, the termination of the Orimulsion program says a great deal about the MEP's and PDVSA's priorities, or lack thereof. As we have frequently reported, PDVSA suffers from a myriad of administrative and operational problems. In addition, Mommer is currently overseeing the migration of operating service agreement fields to PDVSA controlled joint ventures as well as negotiations for the migration of the strategic associations to joint ventures. Despite all of these problems and challenges, MEP and PDVSA devoted time and energy to the elimination of a niche program that is insignificant in the greater scheme of things. As a result, they have soured relations with the Chinese and may have opened themselves up to suits by the holders of supply contracts.

WHITAKER